# STATE OF ALASKA

ALASKA COMMISSION ON POSTSECONDARY EDUCATION

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January 31, 2012

Representative Les Gara, *et al.*
Alaska House of Representatives
State Capitol, Room 500
Juneau, Alaska 99801

Dear Representative Gara:

The following is provided to identify some of the concerns and issues relative to legislation introduced earlier this month, sponsored by you and others. The bill in question is SSHB272, an Act providing for a reduction in interest on postsecondary education loans for residents.

In summary, this bill would require the Alaska Commission on Postsecondary Education (ACPE) to, under certain conditions, reduce the interest rate or provide a rebate of interest on loans which are assets of the Alaska Student Loan Corporation (ASLC). These are: Alaska Student Loans, including consolidation loans (AS 14.43.090-.160); AlaskAdvantage federally guaranteed loans, including consolidation loans (AS 14.43.161-.168); and AlaskAdvantage Supplemental Education Loans (AS 14.170-.175). Not covered are loan types not funded by the ASLC: memorial scholarship loans and WWAMI medical education loans, as well as other ASLC-funded loans: Teacher Education Loans, Alaska Family Education Loans, or WICHE Professional Student Exchange Program Loans.

As currently drafted it appears the rate reduction and/or rebate is to be provided if:

1) the borrower is a state resident;
2) the borrower completed the education for which the loan was issued;
3) the borrower is in repayment;
4) the loan is not in default; and,
5) the loan is not eligible to be repaid or forgiven by a third party.

The reduction/rebate appears to be applicable to any outstanding, otherwise eligible loan.

Let me preface these comments by stating that I recognize the bill sponsors' well-meaning interest in assisting borrowers with managing the increasing costs of postsecondary education. However, as described herein, the approach to doing so as set out in this legislation raises fundamental legal, financial, and operational concerns.

Although the agency services these education loans, ACPE does not own the loans nor are they assets of the state. ASLC is the owner of the loans, and its Board establishes the loan interest rates pursuant to AS 14.43.200, 14.43.165, 14.43.174 etc. As you know, in 1987 the state created ASLC as a separate legal entity and transferred loans originated prior to 1988 to ASLC. Given that, I requested ASLC bond counsel, Ballard Spahr, review and comment on the legislation. The enclosed memorandum from Blake Wade and Darci Stephens of Ballard Spahr identifies two substantial legal issues with the bill as drafted: the possible violation of AS 14.42.270, and a constitutional concern arising from ASLC's contractual relationship with debtholders.

Notwithstanding the legal implications of the proposed legislation, ASLC would face very serious financial and reputational consequences related to this legislative action. Enclosed is a memo from ASLC financial advisor Lee Donner, FirstSouthwest, containing his comments and concerns relative to the proposals in SSHB272. As Mr. Donner notes, the outstanding loans are assets pledged as security for the purposes of repaying outstanding debt and paying operating costs. Any effort to amend the loan terms retroactively will not only result in negative action by bond rating agencies, but even the attempt to do so in this matter may cast a pall over ASLC's future financing opportunities. ASLC anticipates issuing future debt to continue to finance new education loans.

As discussed with you previously, ASLC has, to the extent possible, provided borrower benefits in the form of cost reductions which are annually approved by the Board. Over the past ten years ASLC has provided such benefits to our borrowers totaling approximately $30 million. Benefits have been reduced as a result of various changes impacting ASLC's financial capacity—primarily as a result of the collapse of the asset-backed bond market and resulting increase in the costs of financing. Unlike a depository lender with access to cash at historically low rates, ASLC's lending costs are such that the current net yield on the loan portfolio is less than one percent (0.95%). This bill appears to provide a new entitlement for new and existing borrowers, but without an external source of funding from which to pay the costs of the benefit, which would have serious adverse impacts on ASLC.

In addition to these legal and financial concerns, even were those matters to be resolved in some fashion, implementation of the bill, as proposed, would be highly manual and labor intensive, resulting in significant costs to the state above and beyond the expense of the interest reduction and rebates. Bear in mind that currently covered loan types encompass both fixed and variable rate loans, the base rates of which range from between 2.9% and 9.0%[1] depending on when the loans were originated, and, after borrower benefits are applied, from 0.55% to 7.55%. The bill proposes no floor to the reduction to be paid; therefore, while some borrowers may be

[1] Loans made prior to 2002-03 were charged 0% interest while enrolled in their program of study. The interest began accruing only after they left school, resulting in repayment interest being set at a higher rate.

paying a lower rate, others would be receiving principal reduction credits. Because of the proposed method for determining an individual's rebate, each and every borrower's rebate would be unique given their school enrollment patterns and timeline, and interest rates and related adjustment, as well as their loan(s) status history. As such, both the calculation and benefit application would need to be manually performed.

To be able to respond fully on the feasibility of implementing this benefit program a number of unanswered questions would need to be resolved. These questions include:

- What will be the standard for maintaining residency?
- What does "completion of the education for which the loan was issued" mean—successful completion of the term, academic year, or degree completion/graduation?
- Will a borrower be permitted to move in and out of "default" for the purpose of receiving the interest reduction?
- Will involuntary payments (wage garnishment, PFD garnishment) on a loan make the loan eligible for the interest reduction?
- How will eligibility for loan repayment or forgiveness by a third party be determined?
- What constitutes third-party repayment—does that include available cosigners on the loans?
- Eligibility is "for the time period in which the borrower establishes and maintains residency"—how will instances of borrowers moving in and out of the state while repaying the loan impact their benefit?
- Would borrowers who accelerate their loan repayment be eligible for the benefit, and how would it be paid out in such cases?
- In 14.43.123 (b), what does "amortized and prorated from the beginning of the interest accrual period…" mean?
- In 14.43.123 (c), what does this mean and how is it calculated?
- What is meant by "repayment" period? Loans may be in: in-school, grace, deferment, and forbearance statuses—how are those periods to be treated for borrowers who are in state, either continuously or periodically?
- Given that the language appears to create an unlimited borrower entitlement at the point of loan disbursement, or the effective date of the bill that is triggered by the "completion of education," over what period of years would a borrower be able to stretch their pursuit of that goal and retain their eligibility for the rate reduction and rebate?
- The bill also seems predicated on the idea that the borrower left the state for postsecondary education—how are borrowers who remain in Alaska to be treated with respect to the interest rate reduction and/or interest expense rebate prior to the start of their "repayment period" but before their "completion of education"?

I am very much aware of, and share your growing concerns about, the escalating costs of postsecondary education, specifically as it impacts borrowers' levels of education loan debt. Your support for Alaska Performance Scholarship and AlaskAdvantage Education Grant funding is much appreciated and, I am convinced, will have a positive impact on Alaska's students. In the case of SSHB272, the proposed approach to lowering costs of education loan borrowing is very problematic, and I wanted to bring these matters to your attention prior to a public hearing.

Sincerely,

Diane Barrans
Executive Director/Executive Officer

DB/dv

cc: Representative Sharon Cissna
Representative Berta Gardner
Representative Max Gruenberg
Representative David Guttenberg
Representative Lindsey Holmes
Representative Scott Kawasaki
Representative Beth Kerttula
Representative Bob Miller
Representative Pete Petersen
Representative Chris Tuck

Enclosures

**Ballard Spahr** LLP

**MEMORANDUM**

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| TO | Diane M. Barrans, Alaska Student Loan Corporation |
| FROM | Blake K. Wade<br>Darci L. Stephens |
| DATE | January 27, 2012 |
| RE | Alaska House Bill No. 272 |

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As bond counsel to the Alaska Student Loan Corporation (the "Corporation"), we have been asked to review Alaska House Bill No. 272 ("House Bill 272") on behalf of the Corporation. Set forth below is a brief summary of some of the legal issues raised by House Bill 272.

<u>Violation of Alaska Statutes 14.42.270</u>

As you know, House Bill 272 is designed to provide an interest rate reduction on certain loans (the "Student Loans") issued under the provisions of Alaska law. Pursuant to Alaska Statutes 14.42.100 et seq. (the "Act"), the Corporation has issued various series of bonds and other debt which are secured by a pledge of certain Student Loans. Under Section 14.42.270 of the Act, the State of Alaska (the "State") has pledged to not impair the rights of the Corporation to fulfill its obligations to its bondholders. Section 14.42.270 reads as follows:

> Sec. 14.42.270. Pledge and agreement of state.
> The state pledges to and agrees with holders of bonds issued by the corporation that the state will not limit or alter the rights and powers vested in the corporation under AS 14.42.100 - 14.42.990 to fulfill the terms of a contract made by the corporation with the bondholders or in any way impair the rights and remedies of the bondholders until the bonds, together with the interest on them with interest on unpaid installments of interest, and all costs and expenses in connection with an action or proceeding by or on behalf of the bondholders, are fully met and discharged. The corporation may include this pledge and agreement of the state in a contract with bondholders.

As written, House Bill 272 would result in the reduction of the interest rate on the Student Loans which serve as the source of repayment for the Corporation's bonds. The enactment of House Bill 272 would impair the rights of the Corporation's bondholders and thus appears to violate the "non-impairment" pledge made by the State under Section 14.42.270 of the Act.

Violation of the Alaska and U.S. Constitution

House Bill 272 likely violates both the U.S. Constitution and the Alaska State Constitution. Article I, Section 10 of the U.S. Constitution prohibits a state from passing a "Law impairing the Obligation of Contracts." This "Contract Clause" prohibits states from enacting any law that retroactively impairs contractual rights. Article I, Section 15 of the Alaska Constitution contains a similar provision, which provides that "No law impairing the obligation of contracts . . . shall be passed."

The terms of municipal bonds are contractual obligations protected by the Contract Clause. The U.S. Supreme Court has developed a two-part analysis to determine whether an initiative by a state legislature violates the Contract Clause. This same basic test has been adopted by the courts in Alaska. The Corporation, as a public corporation and governmental instrumentality under Alaska law, would likely be subject to this same analysis. The major determinant for a violation of the Contract Clause is whether the initiative substantially impairs the issuer's obligations to debtholders. House Bill 272 appears to impair the Corporation's obligation to its bond and other debtholders through the reduction of the interest rate on the Student Loans pledged to repay the debt. This reduction in the revenues making up the source of repayment of the Corporation's debt would likely violate both the U.S. Constitution and the Alaska Constitution as an impairment of the Corporation's contract with debtholders.

DLS/

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FirstSouthwest
A PlainsCapital Company

# Memorandum

Lee Donner
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**Date:** January 27, 2012

**To:** Diane Barrans, Executive Officer
Alaska Student Loan Corporation

**Cc:** Charlene Morrison, Chief Financial Officer
Alaska Student Loan Corporation

**Subject:** HB 272, an Act providing for a reduction in interest on Postsecondary education loans for residents

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You have asked that FirstSouthwest Company ("FSC") review Alaska HB 272 and advise Alaska Student Loan Corporation (the "Corporation") as to the implications of this proposed legislation for the currently outstanding student loan financings of the Corporation as well as the impact it might have on future anticipated student loan securitizations issued by the Corporation.

As it currently reads the proposed legislation would create the potential for a significant but unquantifiable reduction in yield on some of the Corporation's student loan portfolios, and does not provide any funding to offset that loss of revenue. In addition, implementation of the provisions in the legislation would be administratively complex and result in the expenditure of some portion of current net revenues on increased operational expense. The Corporation currently has two types of student loan financing vehicles in place: (1) the Straight-A Commercial Paper Conduit program, and (2) multiple student loan revenue bond issues and special project bond issues secured by student loan portfolios. The impact on these financings would vary.

**Straight-A Commercial Paper Conduit:** Implementation of HB 272 would represent a retroactive addition of a significant "borrower benefit" to loans pledged as security under the Corporation's Straight-A borrowing. Had said "borrower benefit" been in place prior to the Corporation executing it's Straight-A borrowing, the program administrator would have, at the least, imposed a higher borrower benefit reserve requirement, and might have precluded the Corporation from pledging any loans that could be subject to the benefit. Should the benefit created by HB 272 take effect after the Corporation has entered into the Straight-A borrowing, the financial implications range from an unquantifiable impairment to the economics of that transaction to the possibility that the Corporation could be required to repurchase those loans from the Straight-A conduit, a requirement that the Corporation might not be able to comply with because it lacks the requisite liquidity to do so.

**Outstanding Bond Issues:** All of the Corporation's outstanding bond issues contain certain covenant restrictions with respect to actions taken or not taken that could have a material impact on the yield of the student loans securing the bonds. I will not attempt to address the legal implications of breaching those covenants, but from a financial perspective, it is a virtual certainty that the rating agencies rating the affected bonds would institute a ratings review with possible outcomes ranging from ratings downgrades to requirements for the deposit of additional assets into the affected trusts, all of which would present significant financial challenges to the Corporation.

**Future Bond Issues/Financings:** New money or refunding bond issues in the student loan arena are already dramatically more challenging as a result of changes to the Higher Education Act, the market impact of the credit crisis of 2009, changes in rating agency criteria for all types of student loan assets, and new regulatory requirements emanating from Dodd/Frank. The administrative and economic impact of HB 272 would put the Corporation in a position where successful execution of new money or refunding transactions would be doubtful at best.

Even if HB 272 were amended to provide state funds to offset the revenue losses on the affected loans, there would still be significant issues with both currently outstanding and future financings, primarily as a result of annual appropriation risk, time lags between loss of revenue and reimbursement, and the fact that utilization of or "take rates" on the benefit are effectively unquantifiable.